No. 12309

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

WIL-RUD CORPORATION,

Appellant,

vs.

E. A. LYNCH, Receiver and Trustee of the Estate of California Associated Products Co., AARON LEVINSON, VICTOR KRAMER, BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, F. W. BOLTZ CORP., and LEO BRILL,

Appellees.

RESPONDENT CREDITORS' REPLY BRIEF.

HUGO A. STEINMEYER,
JOHN E. WALTER and
ROBERT H. FABIAN,
410 Bank of America Building, Los Angeles 14,
Attorneys for the Bank of America National Trust and Savings Association.

AARON LEVINSON,
715 Union Bank Building, Los Angeles 14,
In Pro. Per.

MAURICE MAC GOODSTEIN,
408 Garfield Building, Los Angeles 14,
Attorney for Leo Brill.

OVERTON, SELIG AND WILSON,
908 Quinby Building, Los Angeles 17,
Attorneys for F. W. Boltz Corp.

HUGH WARD LUTZ,
816 Pacific Southwest Building, Los Angeles 14,
Attorney for Victor Kramer.

The Myers Legal Press, Los Angeles. Phone VAndike 9007.

TOPICAL INDEX

TABLE OF AUTHORITIES CITED

Cases

Textbooks

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Appellees.

RESPONDENT CREDITORS' REPLY BRIEF.

Statement of Facts.

On October 22, 1948, certain assets of California Associated Products Co., the bankrupt, were sold at public auction to appellant. The order confirming the sale, which was approved by counsel for the appellant, reads in pertinent part as follows:

> Now, Therefore, the undersigned Referee does hereby approve and confirm the sale by E. A. Lynch, as Receiver in the within estate, of certain personal property, hereinafter described, to Wil-Rud Corporation, a corporation, for a cash consideration to be paid to said E. A. Lynch, as Receiver, in the sum of

$161,000.00, delivery of the assets to be made upon the signing of the within order, and payment therefor to be made concurrently with delivery to the buyer.

1. The Receiver, by this order, is deemed to have sold, and does sell to the buyer, all machinery, fixtures, equipment, all inventory, all lessee's improvements, all furnishings, all supplies, and all finished and unfinished products of every class and character and description whatsoever located at 3631 Union Pacific Avenue, Los Angeles, California, together with all the other *physical* assets of the debtor corporation, wheresoever situated, and together with all of the physical assets of every class and character of the Yankee Doodle Root Beer Company, a corporation, *as of October 15, 1947, at 5:00 o'clock P. M.;* all of said items are sold free and clear of any liens, charges, and encumbrances, save and except a balance owing on a sales contract to the Los Angeles Water Softener Company in the sum of $1,699.17, which balance the purchaser assumes and agrees to pay [Tr. p. 5]. (Emphasis ours.)

Because only $100,000.00 of the purchase price had been paid, the Referee issued an order directing appellant to show cause why it should not pay the $61,000.00 balance due [Tr. p. 10]. At the hearing on the order to show cause, appellant claimed it had no objection to the order confirming the sale [Tr. p. 77], but questioned "the meaning" of the order. At this hearing appellant contended that it did not receive the quantities it purchased,

and that the extensions of prices on an inventory sheet were incorrect [Tr. p. 80]. Appellant's counsel stated that there was nothing in the transcript of the proceedings at the sale on October 15, 1948, which "did not indicate the *ordinary* adjustment between purchaser and seller in this kind of a transaction would not take place, something which takes place every day when shortages develop." [Tr. pp. 111 and 112.] (Emphasis ours.)

The Referee indicated his agreement with this position of the appellant and directed counsel for appellant to prepare an appropriate order [Tr. p. 112]. It was then disclosed that appellant was asserting a claim for empty bottles and cases allegedly purchased but not received [Tr. p. 112]. The Referee directed counsel for the Receiver and appellant to "get together" on a stipulation of facts regarding the alleged shortages of empty bottles and cases [Tr. p. 113].

Instead of preparing the order and stipulation of facts as directed by the Referee, appellant paid $25,000.00 more on the purchase price and made an offer to Receiver to compromise its alleged claims against the Receiver in return for a reduction in the bid price from $161,000.00 to $142,500.00 [Tr. p. 14].

At the subsequent hearing on the Receiver's petition for leave to compromise [Tr. p. 20] these respondent creditors appeared and opposed the proposed compromise [Tr. p. 164 *et seq.*]. Despite the fact that every creditor present at the hearing opposed the compromise (except one, who was non-committal), the Referee verbally ap-

proved the compromise [Tr. p. 167], and then permitted appellant, over the protest of one of the respondents, to offer evidence [Tr. p. 168]. An order was then entered approving the compromise [Tr. p. 20]. Respondent creditors petitioned for a review of that order and the District Court rendered a memorandum opinion, followed by a minute order, in which it reversed the Referee's order [Tr. p. 37].

The appellant here was not a party of record to the proceedings before the District Court. Without leave of any Court, it filed a notice of appeal, and named as appellees all those who were parties to the record in the Courts below.

No order has ever been entered on the order requiring appellant to show cause why the balance of the purchase price should not be paid. Appellant has complied to the extent of paying $25,000.00 of the $61,000.00 due when the order was issued. Appellant also stated on January 29, 1948, it would pay $17,500.00 more that day but has never done so [Tr. p. 122]. That proceeding is not now before this Court. The only questions now before this Court are whether appellant has any standing to prosecute this appeal and whether, if appellant has such standing, the District Court was correct in concluding that the petition to compromise should not have been granted.

Summary of Argument.

I. The appeal should be dismissed because the time for appeal expired before appellant filed his notice of appeal.

II. Appellant has no standing to appeal because it was not and could not have been a party to the proceedings before the Referee on the Receiver's petition to compromise; and because appellant was not aggrieved by the District Court's order denying the petition to compromise.

III. The appeal should be dismissed because it constitutes a collateral attack upon the order confirming the sale to appellant.

IV. The District Court was correct in its conclusion that the petition to compromise should be denied.

(a) The District Court was not bound by the findings and conclusions of the Referee because there was no conflict in the evidence presented.

(b) Since the sale was not made according to any inventory, there could be no inventory shortage to provide a basis for a compromise; the rule of *caveat emptor* applies.

(c) The Referee had the power to sell free from liens, so that there was no ground for any compromise based upon the alleged existence of liens.

ARGUMENT.

I.

The Appeal Should Be Dismissed Because the Time for Appeal Expired Before Appellant Filed Notice of Appeal.

These respondents adopt the argument on this point set out in the brief of respondent E. A. Lynch, Receiver, at pages 10 to 13.

II.

Appellant Has No Standing to Appeal Because It Was Not and Could Not Have Been a Party to the Proceedings Before the Referee on the Receiver's Petition to Compromise; and Because Appellant Was Not Aggrieved by the District Court's Order Denying the Petition to Compromise.

Appellant's rights as a purchaser of the property of the bankrupt estate were prescribed by the order confirming the sale, which was approved by the appellant's counsel before it was entered [Tr. p. 7]. It is to be noted that appellant has never sought to review this order, nor has it ever, by any means, sought to rescind the sale. Rather, appellant chose to attempt to obtain a reduction in the price it had bound itself to pay by making an offer of compromise to the Receiver. The Receiver had no power or authority to bind the bankrupt estate to accept the compromise offer. He could only present it to the Court for approval or rejection. The Bankruptcy Court, and it alone, had the power to change the rights and liabilities of the purchaser which had become fixed when the original order confirming the sale became final. These rights and liabilities could only be changed by an order of the Bankruptcy Court duly entered and allowed to become final.

In this case, appellant's rights and liabilities with respect to the property were never changed after the sale was confirmed because the Referee's order approving the compromise never became final. It follows that appellant was not injured by the District Court's order disapproving the compromise because that order did not adversely affect any vested right of appellant. Since appellant was not injured or aggrieved, it has no standing to appeal.

Appellant had no subsisting right to have it's compromise offer accepted. All the Receiver could have promised appellant was that he would submit the proposed compromise to the Court. By a denial of the petition to compromise appellant did not lose a subsisting right; nor have any of its rights been invaded. Appellant has never had the right to compel the Receiver to perform the terms of the offer to compromise. If the Referee had never made any order with respect to the compromise offer, appellant could not have complained. The District Court's order appealed from, in effect, left appellant in the same position as if no order approving the compromise had ever been entered. The denial of the petition to compromise did not deprive appellant of the two remedies it had for alleged shortages: the right to appeal from the order confirming sale and the right to rescind. If it has now lost either or both of these rights it is entirely appellant's fault.

Counsel in his notice of appeal says appellant is a party aggrieved by the order of the District Court denying the petition to compromise. But is appellant aggrieved? Did appellant lose a "right" to buy the property for $142,500.00? Obviously not, since no final judgment vesting in appellant the right to buy the property for the reduced price was ever entered. Appellant never had such a right. Appellant has been, and still is, in the position of

an onlooker awaiting the acceptance by a principal (the Court) of an offer made through an agent (the Receiver). No Court has entered a final order giving its approval to the proposed compromise. Appellant, therefore, has no standing to appeal.

It is further to be noted that it cannot be demonstrated with any certainty that the denial of the petition to compromise resulted in any injury to appellant, financial or otherwise. Indeed, appellant's counsel stated that "we are not anxious to get the compromise, *candidly,* because the cases do us more good than the amount we are settling for." [Tr. p. 154.] (Emphasis ours.)

In the case of *In re Michigan-Ohio Bldg. Corp.,* 117 F. 2d 191, 194 (1941) (7 Cir.), the Court approved the trustee's account but retained jurisdiction for two years. The appellants who originally were bondholders of the debtor became stockholders under the reorganization plan. They appealed from that portion of the order of the Court which provided for retention of jurisdiction by the Court on the ground that the Court was without authority to reserve power. The Court *sua sponte* raised the question as to whether the appellants had such an interest or were to such a degree aggrieved as to create in them the right to appeal. The Court held no one may appeal from a judgment unless he has an interest therein direct, immediate, pecuniary and substantial. Furthermore, that the right invaded or the injury sustained must be subsisting and immediate, and not one arising as some possible, remote unforeseen consequence.

III.

The Appeal Should Be Dismissed Because it Constitutes a Collateral Attack Upon the Order Confirming the Sale to Appellant.

At the hearing on the order to show cause why it should not pay the $61,000.00 balance, appellant's counsel stated appellant had no objection to the order confirming the sale [Tr. p. 77]. Therefore, there was no basis for an appeal from that order. The only alternative left to appellant was to attempt to rescind the sale. It made no attempt to do this but instead withheld $61,000.00 of the purchase price until the order to show cause was issued. Then appellant proposed a compromise of its claim for shortages and paid $25,000.00 of the $61,000.00 balance owing. It thereby sought to keep the benefits of the sale instead of rescinding and returning the assets; and to get a reduction of the purchase price by offering a compromise to the Receiver.

In *Slocum v. Edwards,* 168 F. 2d 627 (1948) (2nd Cir.), a sale was held of the bankrupt's interest in a trust. All parties including the Referee believed that the subject matter of the sale was the right of the trustee to attach the bankrupt's income from the trust. Long after the sale took place, the bankrupt became entitled to a one-twelfth interest in the trust by reason of the death of another. The bankrupt's estate was reopened and the trustee petitioned the Court for an order setting aside the confirmation of the sale of the interest in the trust. The Referee granted the petition, the District Court reversed, and then the Circuit Court reinstated the order of the Referee.

At page 631 of the opinion of the Circuit Court, there appears the following:

> "As pointed out by Professor Moore, 4 Collier on Bankruptcy (14th Ed. 1942), 1587, 1588, 'The validity of the sale is not open to inquiry or impeachment in any collateral proceeding in either a state or federal court,' and further, 'Collateral attack must be distinguished from a petition or motion to set aside a sale, filed in the bankruptcy proceedings.' On the findings below there is no ground of action against individuals; thus there is no showing of fraud, but only of mutual mistake. Hence the direct correction of the order of confirmation is both the proper and the only appropriate remedy."

As stated in 6 *Remington* at p. 85, Sec. 2584, sales in bankruptcy may not be attacked collaterally. The proper method is by review in the Bankruptcy Court.

IV.

The District Court Was Correct in Its Conclusion That the Petition to Compromise Should Be Denied.

(a) The District Court Was Not Bound by the Findings and Conclusions of the Referee Because There Was No Conflict in the Evidence Presented.

Appellant argues at length that it was error for the District Court to reverse the Referee's order approving the compromise in the absence of a clear abuse of discretion by the Referee (App. Br. p. 51 *et seq.*). In this argument counsel overlooks the fact that there was no dispute before the Referee regarding what occurred at and before the sale; and that there was no question regarding the credibility of witnesses. The question before the District Court was solely one of determining and applying the proper legal principles to the uncontroverted facts. In such a situation, the rule is that the District Court is not bound to give any special sanctity to the findings and conclusions of the Referee. Where, as here, the facts are not controverted, the District Court is in just as good a position as the Referee to draw the proper factual inferences from the undisputed testimony, the record and the documents. The District Judge is in a better position to select and apply the proper rules of law to these factual inferences and to reach a correct decision than is the Referee.

Carr v. Southern Pacific Co., 128 F. 2d 764, 768 (C. C. A. 9, 1942);

Katcher v. Wood, 109 F. 2d 751 (C. C. A. 8, 1940);

Stewart v. Ganey, 116 F. 2d 1010, 1013 (C. C. A. 5, 1941).

(b) Since the Sale Was Not Made According to Any Inventory, There Could Be No Inventory Shortage to Provide a Basis for a Compromise; the Rule of Caveat Emptor Applies.

Appellant contends first that there existed certain inventory shortages which made it only right, proper and imperative that the purchase price be reduced. This contention, we submit, is completely answered by an examination of the order confirming the sale, set forth verbatim in the Statement of Facts.

Where a sale is based upon an inventory, the assets sold should, of course, be checked against the inventory when delivery is made. Here the order confirming the sale contemplated delivery of the assets upon the signing of the order confirming the sale (Oct. 22) but fixed the assets sold as of an earlier date, to wit, 5:00 P. M. October 15, 1947. In other words, the time fixed for delivery of the assets was not the same time as that used to determine the assets sold. This demonstrates that the sale was not based upon an inventory.

There is no reference anywhere in this order to the so-called *July 28* inventory. It was clearly a sale on an "as is, where is" basis as of October *15,* 1947, the date of the sale. The plain meaning of the words "all inventory" in the order was all goods, wares, and merchandise in existence as of the date of sale. Counsel's statement (App. Br. p. 69) that the Referee found that the words "all inventory" meant all items on the July 28 inventory is without support in the record. The Referee made no such finding.

The entire record supports respondents' position as to the meaning of these words. The appellant was advised by the Receiver's attorney in open court on October 15,

1947, a week before the order confirming the sale was signed, that the sale was of "inventory *as is now*" [Tr. p. 69].

The bid had no reference to any inventory, but rather was "for the physical assets" of the bankrupt [Tr. pp. 52, 59, 69]. The appellant was told by the Receiver's agent at the time a copy of the July inventory was furnished that the Receiver had not taken a physical inventory, that the Receiver and the debtor had been operating the business for approximately two months, and that some of the merchandise had been used [Tr. p. 89]. Appellant's own testimony was to the effect that Receiver made no undertakings either before or after the sale to make good or adjust for shortages [Tr. pp. 102-103]. It is significant that the July inventory, which was shown to appellant about ten days before the bidding, was not made by the Receiver and that appellant was advised of this fact [Tr. pp. 85 and 89].

Appellant's principal managing officers and its counsel have both had enough experience with bankruptcy sales to estop them from any plea of ignorance that the rule of *caveat emptor* applies in such sales [Tr. pp. 92, 100].

A second complete answer to appellant's contention that it is entitled to an adjustment of the purchase price is that the rule of *caveat emptor* applies to bankruptcy sales. Professor Collier states the rule as follows:

> The rights and *quantum* of property acquired by the purchaser depend primarily upon the terms of the sale as ordered or agreed upon. In the absence of

> specific warranty clauses the bankruptcy sale is governed by the rule *"caveat emptor."* It is for the purchaser to examine in time what is sold and under what conditions. He may not after discovery of a defect covered by the *"caveat emptor"* principle refuse payment of the purchase price or claim abatement. (4 Collier, Bankruptcy, 14th Ed. p. 1588.)

The learned District Judge in deciding this case cited and relied upon this quotation and upon the following authorities:

> *John Schaap & Sons Drug Co. v. Rone,* 19 F. 2d 517 (C. C. A. 8, 1927);
>
> *Hall v. McGehee,* 37 F. 2d 854 (C. C. A. 5, 1930);
>
> *Handlan v. Bennett,* 51 F. 2d 21 (C. C. A. 4, 1931).

Even where an inventory was submitted to the bidders at public sale it has been held the purchaser is not permitted to withhold a portion of the purchase price on the ground of alleged inventory shortages. *In re Solantkias,* 33 F. 2d 200 (D. C. Pa., 1929). The case is so close on its facts to the instant case that we think it pertinent to quote from the opinion (p. 201):

> We concur in the views expressed by the referee that Diamond had no right to withhold the payment of the $3,500 on account of alleged discrepancies between the inventory and the goods actually turned over by the receiver to Diamond. This was a judicial sale to which the rule of *caveat emptor* clearly applied. If a fraud be practiced upon the purchaser at a public sale, *he should immediately ask to have the sale set aside and return the property.* The court

could then give him the relief to which he is entitled. He could not adjust that matter himself by withholding a part of the purchase money.

The reason for the application of the rule of *caveat emptor* to bankruptcy and judicial sales is that sound public policy dictates the necessity that such sales have a high degree of stability and finality. To apply any other rule is to throw open the door to the practice of purchase price "chiseling" and to invite endless litigation at the expense of creditors. There is no sound reason, nor have we found any precedent for the application of a rule of "equitable adjustment" for which appellant contends. It is submitted that the adoption of such a rule would substantially impair the administration of bankrupt estates. Realizing this, the Courts have uniformly said: "Let the buyer beware!"

It is submitted that since the sale was on an as is, where is basis, the existence of shortages from an inventory made 2½ months before sale by neither the Receiver, the Court nor the purchaser, cannot provide a sound basis for a compromise reduction of the appellant's bid price.

(c) The Referee Had the Power to Sell Free From Liens, so That There Was No Ground for Any Compromise Based Upon the Alleged Existence of Liens.

Appellant contends (App. Br. p. 72 *et seq.*) that the compromise should have been approved because the existence of alleged liens on bottles and cases made it impossible for the Trustee to deliver the property "free and clear of liens."

The transactions between the bankrupt and the holders of the empty cases were nothing more than contracts of "sale and return."

See:

Goebel Brewing Co. v. Brown, 306 Mich. 222, 226, 10 N. W. 2d 835 (1943);

In re Allen, 183 Fed. 172 (E. D. Ark. 1910);

Cf. Buck v. Commissioner, 83 F. 2d 627 (C. C. A. 9, 1936).

Even if we assume for the purpose of the argument that the empty wooden cases and bottles were subject to a lien, the Referee had the power to sell them free from liens, and they were so sold [Tr. p. 5].

6 *Remington on Bankruptcy* 71, Sec. 2577;

Arizona Power Co. v. Smith, 119 F. 2d 888, 890 (1941) (Cir. 9, 1941);

Van Huffel v. Harkelrode, 284 U. S. 225, 227, 52 S. Ct. 115.

The consent of the lienholder (if a lien existed) was not necessary nor was it necessary for the Referee to determine the validity of the alleged lien.

6 *Remington on Bankruptcy,* 77 and 78, Secs. 2578 and 2579.

In any event the alleged lien holder is not before this Court asserting a lien or complaining of the order of the Court confirming the sale.

Conclusion.

The decision of the District Court should be affirmed because:

1. The appeal was taken too late.

2. The appellant was not aggrieved by the order appealed from.

3 This appeal is an attempt to attack collaterally a previously entered appealable order which has become final.

4. On the merits, the District Court was correct in its conclusion that the appellant's offer in compromise should be rejected.

Respectfully submitted,

HUGO A. STEINMEYER,
JOHN E. WALTER and
ROBERT H. FABIAN,
Attorneys for the Bank of America National Trust and Savings Association.

AARON LEVINSON,
In Pro Per.

MAURICE MAC GOODSTEIN,
Attorney for Leo Brill.

OVERTON, SELIG and WILSON,
By FRANK COTTER,
Attorneys for F. W. Boltz Corp.

HUGH WARD LUTZ,
Attorney for Victor Kramer.